

FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
SOUTHWEST MEDICAL CENTER
DECEMBER 31, 2015 AND 2014

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SOUTHWEST MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2015 and 2014

Our discussion and analysis of the financial performance of Southwest Medical Center provides a narrative overview of the Medical Center's financial activities for the years ended December 31, 2015 and 2014. Please read it in conjunction with the accompanying basic financial statements.

In 2015, the Medical Center adopted Governmental Accounting Standards Board (GASB) Statement No. 68, "Accounting and Financial Reporting for Pensions," which revised accounting and reporting standards related to pension plans and multi-employer pension plans. The 2015 and 2014 comparative financial statements have been adjusted to apply this standard retrospectively. An adjustment of \$13,817,622 applicable to 2013 and prior years has been included in the restated 2014 beginning net position balance of the Medical Center to recognize the Medical Center's proportionate share of the defined benefit pension plan unfunded pension liability. This restatement increased the previously reported 2014 change in net position of the Medical Center by \$376,120 as a result of recognizing pension expense on an actuarial basis as compared to a current funding basis. Since the information necessary to completely restate the 2013 financial information is not available, we want to emphasize that the presented 2013 financial information is not comparable to the presented 2015 and 2014 financial information.

Financial highlights

The Medical Center's net position, or equity, increased \$58,697 or 0.2 percent during 2015 and increased \$3,546,383 or 15.2 percent during 2014. If the impact of the pension adjustment is excluded, the Medical Center would have reported a decrease in net position of \$526,138 or 2.0 percent during 2015 and an increase of \$3,170,263 or 13.6 percent during 2014.

The Medical Center reported a \$3,616,816 or 89.5 percent decrease in operating income for 2015 and a \$1,139,492 or 39.3 percent increase in operating income for 2014. If the impact of the pension adjustment is excluded, the Medical Center would have reported a decrease in operating income of \$3,825,531 or 104.4 percent during 2015 and an increase of \$763,372 or 26.3 percent during 2014.

The net position of Southwest Medical Center Foundation (the Foundation), a component unit of the Medical Center, decreased \$198,732 or 2.9 percent during 2015 and increased \$780,536 or 12.8 percent during 2014.

Using these financial statements

The Medical Center's financial statements consist of three statements - a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Net Position; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Medical Center, including resources held by or for the benefit of the Medical Center, and resources restricted for specific purposes by contributors, grantors, and indenture agreements.

One of the most important questions asked about the Medical Center's finances is, "Is the Medical Center, as a whole, better or worse off as a result of the year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position report information about the Medical Center's resources and its activities in a way that helps answer this question.

SOUTHWEST MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended December 31, 2015 and 2014

These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. For purposes of these two statements, revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Medical Center's net position and changes in it. The Medical Center's net position - the difference between assets, deferred outflows, liabilities, and deferred inflows - may be thought of as one way to measure its financial health, or financial position. Over time, increases or decreases in the Medical Center's net position are one indicator of whether its financial health is improving or deteriorating. Consideration must also be given to other nonfinancial indicators, such as changes in the Medical Center's patient base and measures of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of the Medical Center.

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?", "What was cash used for?", and "What was the change in cash balance during the reporting period?"

Assets, deferred outflows, liabilities, deferred inflows, and net position

The Medical Center's statements of net position as of the end of each of the last three years are summarized as follows:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Assets			
Current assets	\$ 14,418,741	\$ 15,875,551	\$ 13,527,655
Assets limited as to use	17,687,992	16,722,397	15,302,544
Capital assets, net	<u>28,280,235</u>	<u>27,616,208</u>	<u>28,671,687</u>
Total assets	<u>60,386,968</u>	<u>60,214,156</u>	<u>57,501,886</u>
Liabilities			
Long-term obligations	(15,660,507)	(16,105,569)	(16,325,159)
Current liabilities	<u>(4,935,098)</u>	<u>(3,791,086)</u>	<u>(4,029,489)</u>
Total liabilities excluding net pension liability	<u>(20,595,605)</u>	<u>(19,896,655)</u>	<u>(20,354,648)</u>
Net pension liability net of deferred outflows and deferred inflows of resources	<u>(12,856,667)</u>	<u>(13,441,502)</u>	<u>(13,817,622)</u>
Net position	<u>\$ 26,934,696</u>	<u>\$ 26,875,999</u>	<u>\$ 23,329,616</u>

Cash and cash equivalents in the current asset category decreased by \$1,396,055 during 2015 and increased by \$1,866,194 during 2014.

Most of the Medical Center's invested cash is set aside by the Board of Trustees for replacement of capital assets or for purchase of additional capital assets. Although, at the discretion of the Board, they may subsequently be used for other purposes, these assets are reported as internally designated assets limited as to

SOUTHWEST MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended December 31, 2015 and 2014

use on the statements of net position. This category of assets increased by \$1,397,785 during 2015 and \$1,418,496 during 2014. Net transfers were made from operating cash to this category of assets that totaled \$4,461,524 in 2015 and \$3,286,494 in 2014.

In aggregate, the Medical Center's unrestricted cash and invested cash total was \$17,137,417 and \$17,135,687 as of December 31, 2015 and 2014, respectively. These represent 154 days and 161 days, respectively, of average cash expenses during each of the years then ended. These figures exceed the median values for other hospitals similar to the Medical Center.

The Medical Center's net patient accounts receivable were 58 percent of current assets as of December 31, 2015, 55 percent as of December 31, 2014, and 62 percent as of December 31, 2013. In relation to net patient service revenue, net patient accounts receivable decreased 2.5 percent during 2015, decreased 3.5 percent during 2014, and increased 27.8 percent during 2013. The average number of days of net patient revenue represented by them was 70 days, 72 days, and 75 days as of December 31, 2015, 2014, and 2013, respectively. The increase in patient accounts receivable that occurred during 2013 was primarily due to employee turnover in both the patient financial services department and the clinic billing office.

No new long-term obligations were incurred during either 2015 or 2014 other than a \$295,400 capital lease obligation in 2014. Subsequent to December 31, 2015, the Medical Center entered into an agreement to refund the bonds issued during 2010.

At the end of 2015, the Medical Center had \$28,280,235 invested in capital assets, net of accumulated depreciation. The total value of new capital assets placed in service totaled \$5,257,160, \$2,537,409, and \$2,459,413 during 2015, 2014, and 2013, respectively.

The Medical Center's net position increased \$58,697 or 0.2 percent during 2015, increased \$3,546,383 or 15.2 percent during 2014, and increased \$2,448,338 or 7.1 percent during 2013. If the impact of the pension adjustment is excluded, the Medical Center would have reported a decrease in net position of \$526,138 or 2.0 percent during 2015 and an increase of \$3,170,263 or 13.6 percent during 2014. The percentage of total assets financed with its net position, or equity, was 44.6 percent, 44.6 percent, and 40.6 percent as of December 31, 2015, 2014, and 2013, respectively.

SOUTHWEST MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended December 31, 2015 and 2014

The Foundation's statements of net position as of the end of its last three fiscal years ended June 30 are summarized as follows:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Assets			
Current assets	\$ 6,194,819	\$ 6,397,407	\$ 5,538,485
Capital assets, net	390,394	393,063	396,832
Other investments	<u>77,144</u>	<u>70,619</u>	<u>145,236</u>
Total assets	6,662,357	6,861,089	6,080,553
Liabilities			
Current liabilities	<u>-</u>	<u>-</u>	<u>-</u>
Net position	<u>\$ 6,662,357</u>	<u>\$ 6,861,089</u>	<u>\$ 6,080,553</u>

The Foundation's current assets consist primarily of investments in marketable securities. The Foundation's net position decreased \$198,732 or 2.9 percent during fiscal year 2015 and increased \$780,536 or 12.8 percent during fiscal year 2014. These changes in net position were primarily influenced by investment market conditions during those years.

Operating results and changes in net position

The Medical Center's operating results and changes in net position for each of the last three years are summarized as follows:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Operating revenues	\$ 44,134,532	\$ 45,724,490	\$ 42,157,263
Operating expenses	(44,294,320)	(42,058,747)	(39,254,892)
Actuarial adjustment to pension expense	<u>584,835</u>	<u>376,120</u>	
Operating income	425,047	4,041,863	2,902,371
Interest expense	(707,230)	(718,450)	(705,943)
Nonoperating revenues	88,380	47,970	151,910
Gain on disposal of capital assets	52,500		
Capital grants and contributions	<u>200,000</u>	<u>175,000</u>	<u>100,000</u>
Increase in net position	<u>\$ 58,697</u>	<u>\$ 3,546,383</u>	<u>\$ 2,448,338</u>

The first, and most significant, component of the overall change in the Medical Center's net position is its operating income - generally, the difference between net patient service revenue and the expenses incurred to perform those services. Operating income decreased \$3,616,816 during 2015 and increased \$1,139,492 during 2014. If the impact of the pension adjustment is excluded, the Medical Center would have reported a decrease in operating income of \$3,825,531 during 2015 and an increase of \$763,372 during 2014.

SOUTHWEST MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended December 31, 2015 and 2014

Gross and net patient service revenue for the past three years are analyzed as follows:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Inpatient services	\$ 47,904,601	\$ 46,258,047	\$ 35,274,469
Outpatient services	66,180,132	65,291,717	60,658,008
Physician services	<u>6,050,850</u>	<u>5,281,779</u>	<u>4,633,195</u>
Gross patient service revenue	120,135,583	116,831,543	100,565,672
Contractual adjustments	(68,135,538)	(63,081,346)	(51,488,882)
Provision for bad debts	(6,994,900)	(8,295,000)	(6,469,700)
Charity care	<u>(1,729,214)</u>	<u>(1,065,370)</u>	<u>(1,836,329)</u>
Net patient service revenue	<u>\$ 43,275,931</u>	<u>\$ 44,389,827</u>	<u>\$ 40,770,761</u>

The Medical Center implemented targeted rate increases for hospital services during January 2015, and it raised all rates for hospital services by 4.5 percent during both October 2015 and January 2014. The actual changes in gross patient service revenue were different than expected because of changes in patient utilization.

Total inpatient days decreased by 1.4 percent and total outpatient registrations increased by 3.9 percent during 2015. Total inpatient days increased by 14.6 percent and total outpatient registrations decreased by 2.8 percent during 2014.

In March and November 2014, two employed hospitalists began active practice for the Medical Center. In September 2014, one employed internal physician became a full time hospitalist for the Medical Center. In August 2014, one family practice physician began practice at the Medical Center. In August 2014, one employed internal medicine physician left the community. In August 2014, an employed internal medicine ARPN began active practice at the Medical Center.

In March 2015, one general surgeon left the community. In September 2015, one family practice physician began practice at the Medical Center. In April and August 2015, two physician assistant hospitalists began active practice for the Medical Center.

The Medical Center has agreements with various third-party payors that provide for payments to the Medical Center at amounts different from its established charge rates. These differences are referred to as contractual adjustments. When expressed as a percentage of gross patient service revenue, the Medical Center's contractual adjustments are comparable to median values for similar hospitals.

The Medical Center provides care free of charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Charity care write-offs increased 62 percent during 2015. Charity care write-offs decreased 42 percent during 2014. The changes during 2015 and 2014 did not occur as a result of policy or criteria changes. The change in 2015 was due to the Medical Center granting charity care to patients with higher outstanding balances. There is a continuing trend in the health care industry to identify and report the value of charity care provided to patients.

SOUTHWEST MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended December 31, 2015 and 2014

Together, the provision for bad debts and charity care write-offs represented 7.3 percent, 8.0 percent, and 8.3 percent of gross patient service revenue during 2015, 2014, and 2013, respectively. The change in 2015 write-offs is due to a difference in the treatment of patients on payment plans with the Medical Center.

Employee salaries and wages increased by \$1,451,835 or 8.0 percent during 2015 and increased by \$1,235,126 or 7.3 percent during 2014. These changes are functions of changes in numbers of employees and in pay rates. Average pay rates increased by 2.8 percent and 3.5 percent during 2015 and 2014, respectively. Total full-time equivalent employees increased by 17 or 5.0 percent during 2015 after increasing by 12 or 3.7 percent during 2014. The increase in numbers of employees during 2015 is primarily due to increases in patient volume, the Medical Center expanding its hospitalist services, and a focus on reducing contract labor.

The cost of employee benefits excluding the pension adjustment was 30.5 percent of salaries and wages during 2015 as compared to 28.2 percent of salaries and wages during 2014. Employee benefit expenses excluding the pension adjustment increased \$865,385 during 2015 and increased \$889,029 during 2014. The primary causes of the changes in both years are variations in costs for a public retirement plan and employee health insurance.

Supplies and other expenses decreased by \$203,163 or 1.3 percent during 2015 and increased by \$308,127 or 2.1 percent during 2014. The 2014 increase occurred primarily because the Medical Center experienced an increase in patient volume. The 2015 decrease occurred primarily because the Medical Center focused on reducing contract nursing labor. These changes are generally consistent with changes in patient volumes experienced by the Medical Center combined with the general rate of health care inflation.

The Foundation's operating results and changes in net position for each of its last three fiscal years ended June 30 are summarized as follows:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Contributions	\$ 50,997	\$ 144,479	\$ 100
Investment income (loss)	(61,258)	799,481	629,255
Other income	109,611	109,397	109,225
Expenses	<u>(298,082)</u>	<u>(272,821)</u>	<u>(177,494)</u>
Change in net position	<u>\$ (198,732)</u>	<u>\$ 780,536</u>	<u>\$ 561,086</u>

Unrealized gains and losses are included in the investment income category on the Foundation's financial statements. The Foundation's investment income included net realized and unrealized gains of \$464,271 and \$637,310 during the years ended June 30, 2013 and 2014, respectively; and included net realized and unrealized losses of \$287,751 during the year ended June 30, 2015. These results followed changes in the broad market indices during those years.



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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Trustees
Southwest Medical Center

We have audited the accompanying financial statements of the business-type activity and discretely presented component unit of Southwest Medical Center (the Medical Center) as of and for the years ended December 31, 2015 and 2014, which collectively comprise the Medical Center's basic financial statements as listed in the table of contents, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express our opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the business-type activity and discretely presented component unit of Southwest Medical Center as of December 31, 2015 and 2014, and the respective changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A21 to the financial statements, in 2015 the Medical Center adopted Governmental Accounting Standards Board (GASB) Statement No. 68, "Accounting and Financial Reporting for Pensions." Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 1 through 6 be presented to supplement the basic financial statements. These standards also require that the pension information listed in the table of contents be included to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the basic financial statements as a whole. The supplementary information presented on pages 35 through 37 is for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole, except that no opinion is expressed as to the adequacy of insurance coverage.

Wendling Hoe Nelson & Johnson LLC
Topeka, Kansas
May 13, 2016

FINANCIAL STATEMENTS

SOUTHWEST MEDICAL CENTER
STATEMENTS OF NET POSITION
December 31,

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	2015		2014	
	Medical Center	Component unit	Medical Center	Component unit
CURRENT ASSETS				
Cash and cash equivalents	\$ 1,942,989	\$ 716,145	\$ 3,339,044	\$ 670,667
Marketable securities		5,478,674		5,726,740
Assets limited as to use	448,297		447,846	
Patient accounts receivable, net of allowance for uncollectible accounts of \$1,815,178 in 2015 and \$6,770,515 in 2014	8,333,222		8,765,992	
Other receivables	418,526		228,758	
Inventories	1,602,773		1,457,312	
Prepaid expenses	1,672,934		1,636,599	
Total current assets	14,418,741	6,194,819	15,875,551	6,397,407
ASSETS LIMITED AS TO USE				
Internally designated	15,194,428		13,796,643	
Under indenture agreements - held by trustee	2,203,956		2,862,865	
By contributors and grantors for capital acquisitions	737,905		510,735	
	18,136,289	-	17,170,243	-
Less amounts required to meet current obligations	448,297		447,846	
	17,687,992	-	16,722,397	-
CAPITAL ASSETS - NET	28,280,235	390,394	27,616,208	393,063
OTHER ASSETS				
Other investments	-	77,144	-	70,619
Total assets	60,386,968	6,662,357	60,214,156	6,861,089
DEFERRED OUTFLOWS OF RESOURCES				
Pension contributions remitted subsequent to the measurement date	813,387		710,025	
Changes in proportion	942,542		382,742	
Total deferred outflows of resources	1,755,929	-	1,092,767	-
Total assets and deferred outflows of resources	\$62,142,897	\$ 6,662,357	\$61,306,923	\$ 6,861,089

The accompanying notes are an integral part of these statements.

LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

	2015		2014	
	Medical Center	Component unit	Medical Center	Component unit
CURRENT LIABILITIES				
Current maturities of long-term obligations	\$ 420,782	\$ -	\$ 407,195	\$ -
Accounts payable	1,722,273		834,312	
Estimated third-party payor settlements	491,941		443,454	
Other accrued liabilities	80,000		87,445	
Accrued salaries and benefits	1,186,355		966,575	
Accrued compensated absences	739,634		754,275	
Accrued interest payable	294,113		297,830	
Total current liabilities	4,935,098	-	3,791,086	-
LONG-TERM OBLIGATIONS, less current maturities	15,660,507		16,105,569	
NET PENSION LIABILITY	13,515,032		12,027,370	
Total liabilities	34,110,637	-	31,924,025	-
DEFERRED INFLOWS OF RESOURCES - PENSION	1,097,564	-	2,506,899	-
NET POSITION				
Invested in capital assets - net of related debt	12,198,946	390,394	11,556,434	393,063
Restricted				
For debt service	1,536,833		1,570,590	
Expendable for capital acquisitions	1,405,028		1,350,019	
For specific operating activities		565,930		575,186
Nonexpendable permanent endowments		660,215		657,779
Unrestricted	11,793,889	5,045,818	12,398,956	5,235,061
Total net position	26,934,696	6,662,357	26,875,999	6,861,089
Total liabilities, deferred inflows of resources, and net position	\$62,142,897	\$ 6,662,357	\$61,306,923	\$ 6,861,089

SOUTHWEST MEDICAL CENTER
STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION
Year ended December 31,

	2015		2014	
	Medical Center	Component unit	Medical Center	Component unit
Operating revenues				
Net patient service revenue	\$43,275,931	\$ -	\$44,389,827	\$ -
Electronic health record incentives	438,647		1,027,210	
Other	419,954		307,453	
Total operating revenues	44,134,532	-	45,724,490	-
Operating expenses				
Salaries and wages	19,590,168		18,138,333	
Employee benefits	5,979,264		5,113,879	
Actuarial adjustment to pension expense	(584,835)		(376,120)	
Supplies and other	15,113,155	295,413	15,316,318	269,052
Depreciation and amortization	3,611,733	2,669	3,490,217	3,769
Total operating expenses	43,709,485	298,082	41,682,627	272,821
Operating income (loss)	425,047	(298,082)	4,041,863	(272,821)
Nonoperating revenues (expenses)				
Investment income	50,842	(61,258)	37,808	799,481
Interest expense	(707,230)		(718,450)	
Noncapital grants and contributions	37,538	50,997	10,162	144,479
Gain on disposal of capital assets	52,500			
Other		109,611		109,397
Total nonoperating revenues (expenses)	(566,350)	99,350	(670,480)	1,053,357
Excess of revenues over (under) expenses before capital grants and contributions	(141,303)	(198,732)	3,371,383	780,536
Capital grants and contributions	200,000		175,000	
Change in net position	58,697	(198,732)	3,546,383	780,536
Net position at beginning of year				
As previously reported	40,317,501	6,861,089	37,147,238	6,080,553
Prior period adjustment for change in accounting principle	(13,441,502)		(13,817,622)	
As restated	26,875,999	6,861,089	23,329,616	6,080,553
Net position at end of year	\$26,934,696	\$ 6,662,357	\$26,875,999	\$ 6,861,089

The accompanying notes are an integral part of these statements.

SOUTHWEST MEDICAL CENTER
STATEMENTS OF CASH FLOWS
Year ended December 31,

	2015		2014	
	<u>Medical Center</u>	<u>Component unit</u>	<u>Medical Center</u>	<u>Component unit</u>
Cash flows from operating activities				
Receipts from and on behalf of patients	\$43,757,188	\$ -	\$44,473,614	\$ -
Payments to or on behalf of employees	(25,346,837)		(22,949,095)	
Payments for supplies and services	(14,600,317)	(295,413)	(16,618,785)	(269,052)
Other receipts and payments	<u>668,833</u>		<u>1,370,791</u>	
Net cash provided (used) by operating activities	<u>4,478,867</u>	<u>(295,413)</u>	<u>6,276,525</u>	<u>(269,052)</u>
Cash flows from noncapital financing activities				
Noncapital grants and contributions	<u>37,538</u>	<u>50,997</u>	<u>10,162</u>	<u>144,479</u>
Cash flows from capital and related financing activities				
Acquisition of capital assets	(4,107,334)		(2,325,515)	
Capital lease obligation incurred			295,400	
Principal payments on long-term obligations	(407,195)		(437,965)	
Interest paid	(735,227)		(746,579)	
Capital grants and contributions	200,000		175,000	
Proceeds from sale of equipment	<u>52,500</u>			
Net cash used by capital and related financing activities	<u>(4,997,256)</u>	<u>-</u>	<u>(3,039,659)</u>	<u>-</u>
Cash flows from investing activities				
Change in assets limited as to use	(968,328)		(1,431,814)	
Change in investments		(39,685)		(276,748)
Other income received		103,086		184,014
Investment income received	<u>53,124</u>	<u>226,493</u>	<u>50,980</u>	<u>162,171</u>
Net cash provided (used) by investing activities	<u>(915,204)</u>	<u>289,894</u>	<u>(1,380,834)</u>	<u>69,437</u>
Net change in cash and cash equivalents	(1,396,055)	45,478	1,866,194	(55,136)
Cash and cash equivalents at beginning of year	<u>3,339,044</u>	<u>670,667</u>	<u>1,472,850</u>	<u>725,803</u>
Cash and cash equivalents at end of year	<u>\$ 1,942,989</u>	<u>\$ 716,145</u>	<u>\$ 3,339,044</u>	<u>\$ 670,667</u>

The accompanying notes are an integral part of these statements.

SOUTHWEST MEDICAL CENTER
STATEMENTS OF CASH FLOWS - CONTINUED
Year ended December 31,

	2015		2014	
	<u>Medical Center</u>	<u>Component unit</u>	<u>Medical Center</u>	<u>Component unit</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities				
Operating income (loss)	\$ 425,047	\$ (298,082)	\$ 4,041,863	\$ (272,821)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities				
Depreciation and amortization	3,611,733	2,669	3,490,217	3,769
Provision for bad debts	6,994,900		8,295,000	
Changes in				
Accounts receivable	(6,562,130)		(8,718,164)	
Other receivables	(189,768)		36,128	
Inventories and prepaid expenses	(181,796)		(186,828)	
Accounts payable and accrued expenses	917,229		(812,522)	
Estimated third-party payor settlements	48,487		506,951	
Net pension liability, deferred inflows, and deferred outflows related to defined benefit pension plan	<u>(584,835)</u>	<u> </u>	<u>(376,120)</u>	<u> </u>
Net cash provided (used) by operating activities	<u>\$ 4,478,867</u>	<u>\$ (295,413)</u>	<u>\$ 6,276,525</u>	<u>\$ (269,052)</u>

The accompanying notes are an integral part of these statements.

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS
December 31, 2015 and 2014

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES

1. Reporting entity

Southwest Medical Center (the Medical Center) is located in Liberal, Kansas, and is owned by Seward County, Kansas (the County), and governed by a seven-member Board of Trustees appointed by the Board of County Commissioners of the County. The Medical Center is a 101-bed, not-for-profit general hospital. The Medical Center can sue and be sued, and can buy, sell, or lease real property. Bond issuances must be approved by the County. The Medical Center is a component unit of the County.

The component unit discussed in Note A2 is included in the Medical Center's reporting entity because of the nature and significance of its relationship with the Medical Center.

2. Component unit

The financial statements include the financial data of the discretely presented component unit described below. The component unit is reported separately to emphasize that it is legally separate from the Medical Center.

Southwest Medical Center Foundation, Inc. (the Foundation), is a not-for-profit corporation formed in August of 1980 to receive, invest, and disburse funds received for the benefit, support, and maintenance of the Medical Center. The Foundation is administered by a Board of Trustees. Three of the seven members of that Board are also members of the Medical Center's Board of Trustees.

Financial data of the Foundation are presented as of June 30, 2015 and 2014, and for the years then ended.

3. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

4. Basis of accounting

The Medical Center uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

5. Cash and cash equivalents

The Medical Center considers all cash and invested cash to be cash equivalents, excluding any assets limited as to use and items classified as investments by the Foundation.

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

6. Allowance for uncollectible accounts

The Medical Center provides for accounts receivable that could become uncollectible in the future by establishing an allowance to reduce the carrying value of such receivables to their estimated net realizable value. The Medical Center estimates this allowance based on the aging of its accounts receivable and its historical collection experience for each type of payor.

7. Inventories

Inventories are stated at the lower of cost or market with cost determined on the first-in, first-out method.

8. Investments and investment income

Investments in debt and equity securities are reported at fair value. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating revenue when earned.

9. Assets limited as to use

Assets limited as to use include assets set aside by the Board of Trustees for replacement of capital assets or for purchase of additional capital assets, over which the Board retains control and may at its discretion subsequently use for other purposes; assets held by a trustee under indenture agreements; and assets restricted by contributors and grantors for capital acquisitions. Assets limited as to use that are required for obligations classified as current liabilities are reported in current assets.

10. Capital assets

Capital assets (including assets recorded as capital leases) are stated at cost. Depreciation and amortization of capital assets are provided on the straight-line method over the estimated useful lives of the assets. The estimated lives used are generally in accordance with the guidelines established by the American Hospital Association.

The costs of maintenance and repairs are charged to operating expenses as incurred. The costs of significant additions, renewals, and betterments to depreciable properties are capitalized and depreciated over the remaining or extended estimated useful lives of the item or the properties. Gains and losses on disposition of capital assets are included in nonoperating revenues and expenses.

11. Costs of borrowing

Interest costs (including amortization of bond premium) incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Original issue premiums and discounts associated with issuance of long-term debt are amortized using the interest method over the term of the related debt.

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

12. Grants and contributions

From time to time, the Medical Center receives grants and contributions from individuals and private organizations. Revenues from grants and contributions are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

13. Estimated health insurance claims payable

The Medical Center is self-insured for health insurance claims of its employees. Management estimates the net liability for reported and unreported claims incurred as of the end of each reporting period. These estimates are based on known claims and historical claims experience.

Management believes that estimates for health insurance claims payable are reasonable. However, it is possible that actual incurred claims expense may vary significantly from the estimate included in the accompanying financial statements.

14. Pension plan

The Medical Center participates in the Kansas Public Employees Retirement System Plan (KPERS), a cost sharing multiple employer defined benefit pension plan. The Medical Center uses information provided by KPERS to measure the net pension liability, deferred outflows of resources, and deferred inflows of resources of the KPERS pension plan.

Deferred outflows of resources represent a consumption of net position that applies to a future period and so will not be recognized as an expense or expenditure until then. Deferred inflows of resources represent an acquisition of net position that applies to a future period and so will not be recognized as revenue until then.

15. Net position

The net position of the Medical Center is classified into four components. "Net position invested in capital assets net of related debt" consists of capital assets net of accumulated depreciation reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. "Restricted expendable net position" is the noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center, including amounts deposited with trustees as required by indenture agreements. "Restricted nonexpendable net position" equals the principal portion of permanent endowments. "Unrestricted net position" is the remaining net position that does not meet the definitions of the other three components of net position.

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

16. Operating revenues and expenses

The Medical Center's statement of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, which is the Medical Center's principal activity. Nonexchange revenues, including noncapital grants and contributions, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

17. Net patient service revenue

Net patient service revenue is reported at established charges with deductions for discounts, charity care, contractual adjustments, and provision for bad debts, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

18. Charity care

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

19. Income taxes

The Medical Center is exempt from federal income taxes pursuant to Sections 115 and 501(a) of the Internal Revenue Code. Management is not aware of any uncertainties in income tax positions. Tax years ending on and before December 31, 2011, are not subject to examination by taxing authorities.

The Foundation is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on its related income pursuant to Section 501(a) of the Code. Management is not aware of any uncertainties in income tax positions. Tax years ending on and before June 30, 2011, are not subject to examination by taxing authorities.

20. Subsequent events

The Medical Center has evaluated subsequent events through May 13, 2016, which is the date the financial statements were available to be issued.

21. Adoption of accounting pronouncement

In 2015, the Medical Center adopted Governmental Accounting Standards Board (GASB) Statement No. 68, "Accounting and Financial Reporting for Pensions," which revised accounting and reporting standards related to pension plans. Comparative financial statements of prior years have been adjusted to apply this standard retrospectively. An adjustment of \$13,817,622 applicable to

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

2013 and prior years has been included in the restated 2014 beginning net position balance of the Medical Center to recognize the Medical Center's proportionate share of the defined benefit pension plan unfunded pension liability. This restatement increased the previously reported change in net position of the Medical Center by \$376,120 as a result of recognizing pension expense on an actuarial basis as compared to a current funding basis.

NOTE B - REIMBURSEMENT PROGRAMS

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established charge rates. The amounts reported on the balance sheets as estimated third-party payor settlements consist of the estimated differences between the contractual amounts for providing covered services and the interim payments received for those services. A summary of the payment arrangements with major third-party payors follows:

Medicare - Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. Inpatient skilled nursing services are paid at prospectively determined per diem rates. Outpatient services are paid at prospectively determined rates per occasion of service. Physician services rendered to Medicare beneficiaries are paid based on a prospectively determined fee schedule.

Prospectively determined rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. The Medical Center is paid for cost reimbursable and other items at tentative rates with final settlement determined after submission of annual cost reports by the Medical Center and audits or reviews thereof by the Medicare administrative contractor. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Medical Center's Medicare cost reports have been audited or reviewed by the Medicare administrative contractor through December 31, 2013.

Medicaid - Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. All other services rendered to Medicaid beneficiaries are paid at prospective rates determined on either a per diem or a fee-for-service basis.

Blue Cross and Blue Shield - All services rendered to patients who are insured by Blue Cross and Blue Shield are paid on the basis of prospectively determined rates per discharge or discounts from established charges.

The Medical Center has also entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Medical Center under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE B - REIMBURSEMENT PROGRAMS - Continued

A summary of gross and net patient service revenue follows:

	<u>2015</u>	<u>2014</u>
Gross patient service revenue	\$ 120,135,583	\$ 116,831,543
Contractual adjustments	(68,135,538)	(63,081,346)
Provision for bad debts	(6,994,900)	(8,295,000)
Charity care	<u>(1,729,214)</u>	<u>(1,065,370)</u>
Net patient service revenue	<u>\$ 43,275,931</u>	<u>\$ 44,389,827</u>

Revenue from the Medicare and Medicaid programs accounted for approximately 24 percent and 9 percent, respectively, of the Medical Center's net patient service revenue during 2015, and 25 percent and 11 percent, respectively, of the Medical Center's net patient service revenue during 2014. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

NOTE C - ELECTRONIC HEALTH RECORD INCENTIVE PAYMENTS

The American Recovery and Reinvestment Act of 2009 (ARRA) provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified electronic health record (EHR) technology. These provisions of ARRA are intended to promote the adoption and meaningful use of interoperable health information technology and qualified EHR technology.

The Medical Center recognizes revenue for EHR incentive payments when it has reasonable assurance that it has demonstrated meaningful use of certified EHR technology for the applicable period and complied with the reporting conditions to receive the payment. The demonstration of meaningful use is based upon meeting a series of objectives and varies between hospital facilities and physician practices and between the Medicare and Medicaid programs. Additionally, meeting the objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by CMS. During the years ended December 31, 2015 and 2014, the Medical Center recognized \$438,647 and \$1,027,210, respectively, of revenue for EHR incentive payments.

The Medical Center incurs both capital expenditures and operating expenses in connection with the implementation of its EHR initiatives. The amounts and timing of these expenditures do not directly correlate with the timing of the Medical Center's recognition of EHR incentive payments as revenue.

NOTE D - DEPOSITS WITH FINANCIAL INSTITUTIONS

Kansas statutes authorize the Medical Center, with certain restrictions, to deposit or invest in open accounts, time deposits, certificates of deposit, repurchase agreements, U.S. Treasury Bills and Notes, and the State Treasurer's investment pool. Kansas statutes also require that collateral be pledged for bank deposits with a fair market value equal to 100 percent of the uninsured amounts and must be assigned for the benefit of the Medical Center.

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE D - DEPOSITS WITH FINANCIAL INSTITUTIONS - Continued

At December 31, 2015, the carrying amount of the Medical Center's bank deposits, including certificates of deposit, was \$17,869,296 and the bank balances were \$18,294,676. Of the bank balances, \$500,000 was covered by federal depository insurance and \$17,794,676 was covered by collateral held by a third-party bank, but not registered in the Medical Center's name.

The Medical Center's bank deposits are included in the financial statements under the following categories:

Cash and cash equivalents	\$ 1,939,865
Assets limited as to use	
Internally designated	15,191,526
By contributors and grantors	
for capital acquisitions	<u>737,905</u>
Total bank deposits	<u>\$ 17,869,296</u>

NOTE E - INVESTMENTS

The Foundation's investments are stated at fair value. The composition of its investments is as follows:

	<u>2015</u>	<u>2014</u>
Equity securities	\$ 5,336,283	\$ 5,586,019
Fixed income securities	<u>142,391</u>	<u>140,721</u>
	<u>\$ 5,478,674</u>	<u>\$ 5,726,740</u>

NOTE F - ASSETS LIMITED AS TO USE

The composition of assets limited as to use is as follows:

	<u>2015</u>	<u>2014</u>
Internally designated		
Cash	\$ 7,691,526	\$ 6,291,459
Certificates of deposit	7,500,000	7,500,000
Accrued interest receivable	<u>2,902</u>	<u>5,184</u>
	<u>\$ 15,194,428</u>	<u>\$ 13,796,643</u>
Under indenture agreements - held by trustee		
U.S. Treasury obligations	<u>\$ 2,203,956</u>	<u>\$ 2,862,865</u>
By contributors and grantors for capital acquisitions		
Cash	<u>\$ 737,905</u>	<u>\$ 510,735</u>

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE G - CAPITAL ASSETS

Capital asset additions, retirements, and balances for the Medical Center are as follows:

	2015			
	<u>Beginning balance</u>	<u>Transfers and additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 104,046	\$ -	\$ -	\$ 104,046
Land improvements	2,951,334			2,951,334
Buildings and fixed equipment	41,227,299	3,408,354	218,416	44,417,237
Major movable equipment	<u>37,586,082</u>	<u>1,848,806</u>	<u>6,808,080</u>	<u>32,626,808</u>
Totals at historical cost	<u>81,868,761</u>	<u>5,257,160</u>	<u>7,026,496</u>	<u>80,099,425</u>
Less accumulated depreciation and amortization				
Land improvements	1,096,661	102,583		1,199,244
Buildings and fixed equipment	23,686,273	1,306,089	218,416	24,773,946
Major movable equipment	<u>30,771,299</u>	<u>2,203,061</u>	<u>6,808,080</u>	<u>26,166,280</u>
	<u>55,554,233</u>	<u>3,611,733</u>	<u>7,026,496</u>	<u>52,139,470</u>
Construction in progress	26,314,528	1,645,427	-	27,959,955
	<u>1,301,680</u>	<u>(981,400)</u>		<u>320,280</u>
Capital assets, net	<u>\$27,616,208</u>	<u>\$ 664,027</u>	<u>\$ -</u>	<u>\$28,280,235</u>

	2014			
	<u>Beginning balance</u>	<u>Transfers and additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 104,046	\$ -	\$ -	\$ 104,046
Land improvements	2,951,334			2,951,334
Buildings and fixed equipment	41,104,356	122,943		41,227,299
Major movable equipment	<u>35,171,616</u>	<u>2,414,466</u>		<u>37,586,082</u>
Totals at historical cost	<u>79,331,352</u>	<u>2,537,409</u>	<u>-</u>	<u>81,868,761</u>
Less accumulated depreciation and amortization				
Land improvements	989,929	106,732		1,096,661
Buildings and fixed equipment	22,399,702	1,286,571		23,686,273
Major movable equipment	<u>28,674,385</u>	<u>2,096,914</u>		<u>30,771,299</u>
	<u>52,064,016</u>	<u>3,490,217</u>	<u>-</u>	<u>55,554,233</u>
Construction in progress	27,267,336	(952,808)	-	26,314,528
	<u>1,404,351</u>	<u>(102,671)</u>		<u>1,301,680</u>
Capital assets, net	<u>\$28,671,687</u>	<u>\$ (1,055,479)</u>	<u>\$ -</u>	<u>\$27,616,208</u>

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE G - CAPITAL ASSETS - Continued

Construction in progress at December 31, 2015 and 2014, consisted mainly of costs incurred for various items of equipment, software upgrades, and building renovation projects.

Capital asset additions, retirements, and balances for the Foundation are as follows:

	2015			
	<u>Beginning balance</u>	<u>Transfers and additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 374,526	\$ -	\$ -	\$ 374,526
Land improvements	96,231			96,231
Major movable equipment	<u>2,079</u>	<u> </u>	<u> </u>	<u>2,079</u>
Totals at historical cost	472,836	-	-	472,836
Less accumulated depreciation and amortization	<u>79,773</u>	<u>2,669</u>	<u> </u>	<u>82,442</u>
Capital assets, net	<u>\$ 393,063</u>	<u>\$ (2,669)</u>	<u>\$ -</u>	<u>\$ 390,394</u>

	2014			
	<u>Beginning balance</u>	<u>Transfers and additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 374,526	\$ -	\$ -	\$ 374,526
Land improvements	96,231			96,231
Major movable equipment	<u>2,079</u>	<u> </u>	<u> </u>	<u>2,079</u>
Totals at historical cost	472,836	-	-	472,836
Less accumulated depreciation and amortization	<u>76,004</u>	<u>3,769</u>	<u> </u>	<u>79,773</u>
Capital assets, net	<u>\$ 396,832</u>	<u>\$ (3,769)</u>	<u>\$ -</u>	<u>\$ 393,063</u>

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE H - LONG-TERM OBLIGATIONS

Long-term obligations are summarized as follows:

	<u>2015</u>	<u>2014</u>
2.0% to 5.0% General Obligation Hospital Refunding and Improvement Bonds, Series 2010-A; issued on May 27, 2010, in the original amount of \$17,670,000, due serially through August 1, 2040, including unamortized premium of \$356,049 in 2015 and \$380,329 in 2014	\$ 15,916,049	\$ 16,300,329
Capital lease obligation, imputed interest rate of 7.4%, collateralized by leased equipment with an amortized cost of \$155,906 at December 31, 2015	<u>165,240</u>	<u>212,435</u>
	16,081,289	16,512,764
Less current maturities	<u>420,782</u>	<u>407,195</u>
	<u>\$ 15,660,507</u>	<u>\$ 16,105,569</u>

On May 27, 2010, the County issued \$17,670,000 in General Obligation Hospital Refunding and Improvement Bonds, Series 2010-A, (the 2010-A bonds) on behalf of the Medical Center pursuant to a bond trust indenture dated May 1, 2010. The proceeds of the bonds were used, together with other available funds of the Medical Center, for the purpose of providing funds to (1) expand and renovate the Medical Center's existing facilities, (2) pay for the costs of certain items of equipment, (3) fund a debt service reserve fund, (4) pay certain costs related to issuance of the bonds, and (5) make the payment as scheduled on August 1, 2010, for principal and interest due then on the 2001-A bonds.

The indenture agreements for the bonds require the Medical Center to transfer to a trustee, on a monthly basis, specified amounts which, when combined with interest earned on the respective funds held by the trustee, will provide sufficient funds to pay the bond principal and interest on the appropriate due dates. Such amounts were maintained and are included with assets limited as to use in the financial statements. The indenture agreements also include certain restrictive covenants relating to the acquisition and disposition of property, incurrence of additional indebtedness, and level of fees and rates charged.

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE H - LONG-TERM OBLIGATIONS - Continued

Scheduled annual debt service requirements on long-term debt are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 370,000	\$ 712,062	\$ 1,082,062
2017	380,000	700,963	1,080,963
2018	395,000	688,613	1,083,613
2019	410,000	675,775	1,085,775
2020	420,000	661,425	1,081,425
2021 - 2025	2,335,000	3,075,790	5,410,790
2026 - 2030	2,880,000	2,539,000	5,419,000
2031 - 2035	3,680,000	1,742,500	5,422,500
2036 - 2040	<u>4,690,000</u>	<u>726,250</u>	<u>5,416,250</u>
	<u>\$ 15,560,000</u>	<u>\$ 11,522,378</u>	<u>\$ 27,082,378</u>

The following is a yearly schedule of future minimum lease payments under capital lease obligations as of December 31, 2015:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 50,782	\$ 10,578	\$ 61,360
2017	54,715	6,645	61,360
2018	55,005	2,566	57,571
2019	<u>4,738</u>	<u>30</u>	<u>4,768</u>
	<u>\$ 165,240</u>	<u>\$ 19,819</u>	<u>\$ 185,059</u>

The following is a summary of changes in long-term obligations:

	<u>Capital lease obligation</u>	<u>Bonds</u>	<u>Total long-term obligations</u>
Outstanding at January 1, 2014	\$ -	\$ 16,680,159	\$ 16,680,159
Obligations incurred	295,400		295,400
Principal payments	(82,965)	(355,000)	(437,965)
Amortization of premium	<u></u>	<u>(24,830)</u>	<u>(24,830)</u>
Outstanding at January 1, 2015	212,435	16,300,329	16,512,764
Principal payments	(47,195)	(360,000)	(407,195)
Amortization of premium	<u></u>	<u>(24,280)</u>	<u>(24,280)</u>
Outstanding at December 31, 2015	<u>\$ 165,240</u>	<u>\$ 15,916,049</u>	<u>\$ 16,081,289</u>

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE H - LONG-TERM OBLIGATIONS - Continued

Total interest costs are summarized as follows:

	<u>2015</u>	<u>2014</u>
Total interest incurred	\$ 731,510	\$ 743,280
Amortization of bond premium	<u>(24,280)</u>	<u>(24,830)</u>
Interest expense	<u>\$ 707,230</u>	<u>\$ 718,450</u>

NOTE I - DEFINED BENEFIT PENSION PLAN

Plan description

The Medical Center participates in the Kansas Public Employees Retirement System (KPERS), a cost-sharing multiple-employer defined benefit pension plan as provided by K.S.A. 74-4901, etc. seq. Substantially all employees of the Medical Center are eligible to participate in KPERS. KPERS provides retirement benefits, life insurance, disability income benefits, and death benefits. Kansas law establishes and amends benefit provisions. Substantially all public employees in Kansas are covered by KPERS. Participation by local political subdivisions and entities is optional, but irrevocable once elected. KPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to KPERS (611 S. Kansas Avenue, Suite 100, Topeka, Kansas 66603-3869) or by calling 1-888-275-5737.

Benefits

Benefits are established by statute and may only be changed by the Kansas Legislature. Members with ten or more years of credited service may retire as early as age 55, with an actuarially reduced monthly benefit. Normal retirement is at age 65, age 62 with ten years of credited service, or whenever a member's combined age and years of credited service equal 85 "points."

Monthly retirement benefits are based on a statutory formula that includes final average salary and years of service. When ending employment, members may withdraw their contributions from their individual accounts, including interest. Members who withdraw their accumulated contributions lose all rights and privileges of membership. For all pension coverage groups, the accumulated contributions and interest are deposited into and disbursed from the membership accumulated reserve fund as established by K.S.A. 74-4922.

Members choose one of seven payment options for their monthly retirement benefits. At retirement a member may receive a lump-sum payment of up to 50 percent of the actuarial present value of the member's lifetime benefit. His or her monthly retirement benefit is then permanently reduced based on the amount of the lump sum. Benefit increases, including ad hoc post-retirement benefit increases, must be passed into law by the Kansas Legislature. Benefit increases are under the authority of the Legislature and the Governor of the State of Kansas. For all pension coverage groups, the retirement benefits are disbursed from the retirement benefit payment reserve fund as established by K.S.A. 74-4922.

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE I - DEFINED BENEFIT PENSION PLAN - Continued

Contributions

Member contributions are established by state law, and are paid by the employee according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rates be determined based on the results of an annual actuarial valuation for each of the three state-wide pension groups. The contributions and assets of all groups are deposited in the Kansas Public Employees Retirement Fund established by K.S.A. 74-4921. All of the retirement systems are funded on an actuarial reserve basis.

Effective July 1, 2009, KPERS has two benefit structures and funding depends on whether the employee is a Tier 1 or Tier 2 member. Tier 1 members are active and contributing members hired before July 1, 2009. Tier 2 members were first employed in a covered position on or after July 1, 2009. Kansas law establishes the KPERS member-employee contribution rate of 5 percent of covered salary of Tier 1 members and at 6 percent of covered salary for Tier 2 members. Beginning January 1, 2015, the KPERS Tier 1 member-employee contribution rate was 6 percent of covered salary. The employer rates established by statute at December 31, 2015 and 2014, are 9.48 percent and 8.84 percent, respectively. The Medical Center employer contributions to KPERS for the years ended December 31, 2015 and 2014, were \$1,677,391 and \$1,460,959, respectively, equal to the statutory required contributions for each year.

Employer and nonemployer allocations

Although KPERS administers one cost-sharing multiple-employer defined benefit pension plan, separate (sub) actuarial valuations are prepared to determine the actuarial determined contribution rate by group. Following this method, the measurement of the collective net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense are determined separately for each of the following groups of the plan:

- State/School
- Local
- Police and Firemen
- Judges

To facilitate the separate (sub) actuarial valuations, the System maintains separate accounts to identify additions, deductions, and fiduciary net position applicable to each group. The Medical Center is included in the local group. The allocation percentages presented for each group in the schedule of employer and nonemployer allocations are applied to amounts presented in the schedules of pension amounts by employer and nonemployer. The allocation percentages for the Medical Center's share of the collective pension amounts as of December 31, 2015 and 2014, are based on the ratio of each employer's contributions to total employer and nonemployer contributions of the group for the years ended June 30, 2015 and 2014, respectively. The contributions used exclude contributions made for prior service, excess benefits, and irregular payments. As of December 31, 2015, the Medical Center's proportion was 1.029 percent which was an increase of .052 from its share at December 31, 2014.

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE I - DEFINED BENEFIT PENSION PLAN - Continued

Net pension liability

At December 31, 2015 and 2014, the Medical Center reported a liability of \$13,515,032 and \$12,027,370, respectively, for its proportionate share of the net pension liability.

Actuarial assumptions

The total pension liability was determined by actuarial valuations as of December 31, 2014 and 2013, which were then rolled forward to June 30, 2015 and 2014, using the following actuarial assumptions:

<u>Actuarial assumptions</u>	<u>2014</u>	<u>2013</u>
Price inflation	3.00%	3.00%
Wage inflation	4.00%	4.00%
Salary increases, including wage increases	4.00% - 16.00%	4.00% - 12.50%
Long-term rate of return net of investment expense and including price inflation	8.00%	8.00%

Mortality rates were based on the RP-2000 Combined Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements on Scale AA.

The actuarial assumptions used in the December 31, 2014 valuation were based on the results of an actuarial experience study conducted for the three-year period ending December 31, 2012. The actuarial assumptions used in the December 31, 2013 valuation were based on the results of an actuarial experience study conducted for the three-year period ending December 31, 2009.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE I - DEFINED BENEFIT PENSION PLAN - Continued

arithmetic real rates of return for each major asset class included in the pension plan's target asset allocations as of June 30, 2015, are summarized in the following table:

<u>Asset class</u>	<u>Long-term target allocation</u>	<u>Long-term expected real rate of return</u>
Global equity	47.00 %	6.30 %
Fixed income	13.00	0.80
Yield driven	8.00	4.20
Real return	11.00	1.70
Real estate	11.00	5.40
Alternatives	8.00	9.40
Short-term investments	<u>2.00</u>	(0.50)
Total	<u>100.00 %</u>	

Discount rate

The discount rate used to measure the total pension liability was 8.00 percent. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the contractually required rate. The State, School, and Local employers do not necessarily contribute the full actuarial determined rate. Based on legislation passed in 1993, the employer contribution rates certified by the System's Board of Trustees for these groups may not increase by more than the statutory cap. The expected KPERS employer statutory contribution was modeled for future years, assuming all actuarial assumptions are met in future years. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the net pension liability to changes in the discount rate

The following table presents the net pension liability of the pension plan as of June 30, 2015, calculated using the discount rate of 8.00 percent, as well as what the pension plan's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (7.00 percent) or 1-percentage-point higher (9.00 percent) than the current rate:

	1% decrease (7.00%)	Current discount rate (8.00%)	1% increase (9.00%)
Medical Center's share of net pension liability	\$19,185,305	\$13,515,032	\$ 8,707,754

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE I - DEFINED BENEFIT PENSION PLAN - Continued

Pension expense

For the years ended December 31, 2015 and 2014, the Medical Center recognized pension expense of \$1,108,272 and \$1,084,839, respectively, which includes the changes in the collective net pension liability, projected earnings on pension plan investments, and the amortization of deferred outflows of resources and deferred inflows of resources for the period.

Deferred outflows of resources and deferred inflows of resources

A summary of the collective deferred outflows of resources and deferred inflows of resources at December 31, 2015 and 2014, are included in the tables below. Experience gains/losses and the impact of changes in actuarial assumptions or other inputs, if any, are recognized over the average expected remaining service life of the active and inactive plan members at the beginning of the measurement period. Investment gains and losses are recognized over a fixed five-year period.

	<u>2015</u>	<u>2014</u>
Deferred outflows of resources		
Changes in proportion and differences between Medical Center contributions and proportionate share of contributions	\$ 942,542	\$ 382,742
Employer contributions subsequent to the measurement date	<u>813,387</u>	<u>710,025</u>
Total deferred outflows of resources	<u>\$ 1,755,929</u>	<u>\$ 1,092,767</u>
Deferred inflows of resources		
Differences between expected and actual experience	\$ 382,582	\$ 341,530
Changes of assumptions	188,888	
Net difference between projected and actual earnings on pension plan investments	<u>526,094</u>	<u>2,165,369</u>
Total deferred inflows of resources	<u>\$ 1,097,564</u>	<u>\$ 2,506,899</u>

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE I - DEFINED BENEFIT PENSION PLAN - Continued

The following table provides the deferred outflows of resources and deferred inflows of resources as of December 31, 2015, that will be recognized in pension expense in future years:

Year ended December 31,	Employer contributions subsequent to the measurement date	Recognition of net deferred outflows/(inflows) of resources by year	Total
2016	\$ 813,387	\$ (194,024)	\$ 619,363
2017		(194,024)	(194,024)
2018		(194,024)	(194,024)
2019		372,785	372,785
2020		54,265	54,265
	<u>\$ 813,387</u>	<u>\$ (155,022)</u>	<u>\$ 658,365</u>

NOTE J - EMPLOYEE HEALTH INSURANCE

The Medical Center is self-insured for health insurance claims of its employees. The Medical Center has reinsured a portion of its risk for such claims. The reinsurance arrangement covers annual claims in excess of \$75,000 for each covered individual. The reinsurance arrangement also covers aggregate annual claims in excess of an amount determined in relation to the number of individuals participating in the self-insured health benefits plan during the year. Covered employees also provide part of the funds to pay claims through monthly contributions at predetermined rates. Contributions by the Medical Center and participating employees are remitted to the Southwest Medical Center Employee Health Plan Trust. The Trust has retained an insurance company as its agent to process and settle claims. The Trust reimburses the agent weekly for the amount of claims paid by the agent net of any amounts covered by reinsurance. The following is a summary of the activity under this arrangement:

	<u>2015</u>	<u>2014</u>
Estimated net health insurance claims payable at beginning of year	\$ 245,292	\$ 245,238
Provision for Medical Center's share of incurred claims and related expenses for the year, net of any reinsurance proceeds	2,287,418	1,906,742
Employee contributions	880,188	785,577
Payments made for claims and related expenses	<u>(3,122,190)</u>	<u>(2,692,265)</u>
Estimated net health insurance claims payable at end of year	290,708	245,292
Trust assets available for payment of claims and related expenses	<u>1,216,673</u>	<u>1,191,253</u>
Net estimated prepaid expense for health insurance claims at end of year	<u>\$ (925,965)</u>	<u>\$ (945,961)</u>

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE K - CONCENTRATION OF CREDIT RISK

The Medical Center grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31, 2015 and 2014, is as follows:

	<u>2015</u>	<u>2014</u>
Medicare	22%	16%
Medicaid	8	12
Blue Cross	14	11
Other third-party payors	27	15
Self-pay	<u>29</u>	<u>46</u>
	<u>100%</u>	<u>100%</u>

NOTE L - RELATED PARTY TRANSACTIONS

During 2015 and 2014, the Medical Center received \$200,000 and \$175,000, respectively, from the Foundation for the purchase of property and equipment.

NOTE M - RISK MANAGEMENT

For the years ended December 31, 2015 and 2014, the Medical Center was insured for professional liability under a comprehensive hospital liability policy provided by an independent insurance carrier with limits of \$200,000 per occurrence up to an annual aggregate of \$600,000 for all claims made during the policy year. The Medical Center is further covered by the Kansas Health Care Stabilization Fund for claims in excess of its comprehensive hospital liability policy up to \$800,000 pursuant to any one judgment or settlement against the Medical Center for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy year in the amount of \$2,400,000. The policy provided by the independent insurance carrier provides for umbrella liability coverage in excess of the underlying limits set forth above in the amount of \$2,000,000 per occurrence with an aggregate amount in any policy year of \$2,000,000. All coverage is on a claims-made basis. The above policies are currently in effect through November 21, 2016. The Medical Center intends to renew this coverage on that date and is aware of no reason why such coverage would be denied at that time.

In addition to the risks disclosed elsewhere in these financial statements and notes thereto, the Medical Center is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Medical Center purchases commercial insurance for these risks. Settled claims have not exceeded this commercial coverage in any of the past three years.

SOUTHWEST MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2015 and 2014

NOTE N - SUBSEQUENT EVENT

On March 30, 2016, the County issued \$9,480,000 in General Obligation Hospital Refunding Bonds (the 2016 bonds). The proceeds of the 2016 bonds were used to advance refund \$8,335,000 of the 2010-A bonds and pay certain costs related to issuance of the 2016 bonds.

SUPPLEMENTARY INFORMATION

SOUTHWEST MEDICAL CENTER
SCHEDULE OF MEDICAL CENTER'S PROPORTIONATE SHARE OF
THE NET DEFINED PENSION PLAN LIABILITY
December 31,

	<u>2015</u>	<u>2014</u>
Medical Center's proportion of the net pension liability	1.0293%	0.9772%
Medical Center's proportionate share of the net pension liability	\$ 13,515,032	\$ 12,027,370
Medical Center's covered-employee payroll	\$ 17,693,998	\$ 16,526,686
Medical Center's proportionate share of the net pension liability as a percentage of its covered-employee payroll	76.38%	72.78%
Plan fiduciary net position as a percentage of the total pension liability	71.98%	72.56%

SOUTHWEST MEDICAL CENTER
SCHEDULE OF MEDICAL CENTER CONTRIBUTIONS TO
DEFINED PENSION PLAN
December 31,

	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Contractually required contribution	\$ 1,677,391	\$ 1,460,959	\$ 1,239,538	\$ 1,118,958	\$ 1,054,114	\$ 975,565	\$ 813,535	\$ 590,301	\$ 523,955	\$ 451,370
Contributions in relation to the contractually required contribution	<u>(1,677,391)</u>	<u>(1,460,959)</u>	<u>(1,239,538)</u>	<u>(1,118,958)</u>	<u>(1,054,114)</u>	<u>(975,565)</u>	<u>(813,535)</u>	<u>(590,301)</u>	<u>(523,955)</u>	<u>(451,370)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Hospital's covered-employee payroll	\$17,693,998	\$16,526,686	\$15,611,310	\$15,244,659	\$15,639,674	\$15,888,681	\$14,684,747	\$11,973,651	\$12,156,729	\$11,815,969
Contributions as a percentage of covered-employee payroll	9.48%	8.84%	7.94%	7.34%	6.74%	6.14%	5.54%	4.93%	4.31%	3.82%

SOUTHWEST MEDICAL CENTER
BALANCE IN DEPOSITORY COMPARED WITH DEPOSITORY SECURITY
December 31, 2015

	<u>Bank balances</u>	<u>F.D.I.C. coverage</u>	<u>Balance subject to pledging of securities</u>	<u>Market value of securities pledged</u>	<u>Market value of securities pledged in excess of (less than) depository requirements</u>
First National Bank	\$ 12,294,676	\$ 250,000	\$ 12,044,676	\$ 12,884,637	\$ 839,961
Community Bank	6,000,000	250,000	5,750,000	5,863,155	113,155

SOUTHWEST MEDICAL CENTER
SCHEDULE OF REVENUES AND EXPENSES
WITH BUDGET COMPARISON
Year ended December 31, 2015

	<u>Actual</u>	<u>Budget</u>	<u>Over (under)</u>
Net patient service revenue	\$ 43,275,931	\$ 46,781,654	\$ (3,505,723)
Other	<u>858,601</u>	<u>353,001</u>	<u>505,600</u>
Total operating revenues	44,134,532	47,134,655	(3,000,123)
Total operating expenses	<u>43,709,485</u>	<u>43,858,061</u>	<u>(148,576)</u>
Operating income	425,047	3,276,594	(2,851,547)
Nonoperating revenues (expenses)	<u>(566,350)</u>	<u>(537,006)</u>	<u>(29,344)</u>
Excess of revenues over (under) expenses before capital grants and contributions	<u>\$ (141,303)</u>	<u>\$ 2,739,588</u>	<u>\$ (2,880,891)</u>

SOUTHWEST MEDICAL CENTER
SUMMARY OF INSURANCE COVERAGE
December 31, 2015

<u>Insurer</u>	<u>Type of coverage</u>	<u>Coverage amount</u>	<u>Term</u>
KaMMCO Insurance Company	Hospital professional liability Other liability Personal injury/property	HPL \$200,000/\$600,000 PL \$1,000,000/\$3,000,000 PIP \$1,000,000/\$1,000,000	November 21, 2015 to November 21, 2016
Kansas Health Care Provider Insurance Availability Act	Excess hospital professional liability	\$800,000/\$2,400,000	November 21, 2015 to November 21, 2016
KaMMCO Insurance Company	Umbrella liability	\$2,000,000/\$2,000,000	November 21, 2015 to November 21, 2016
Darwin Insurance Co.	Directors, Officers, and Trustees liability Employment practices liability	\$2,000,000/\$2,000,000 \$2,000,000/\$2,000,000	November 21, 2015 to November 21, 2016
KaMMCO Insurance Company	Fire legal liability	\$50,000/\$50,000	November 21, 2015 to November 21, 2016
Travelers Insurance Company	Property	Real - \$56,345,600 Personal - \$25,396,200 Business interruption - \$31,631,868	June 30, 2015 to June 30, 2016
Hartford Insurance Company	Auto liability and physical damage	\$1,000,000/\$1,000,000	June 30, 2015 to June 30, 2016
Hartford Insurance Company	Commercial crime	Blanket employee dishonesty and forgery/alteration - \$100,000 Theft, burglary - \$10,000	June 30, 2015 to June 30, 2016
Travelers Insurance Company	Commercial crime	Excess employee dishonesty - \$250,000	June 30, 2015 to June 30, 2016
KHA Workers' Compensation Fund, Inc.	Workers' compensation and employers liability (Kansas)	Statutory: Bodily injury by accident - \$500,000 each accident Bodily injury by disease - \$500,000 policy limit Bodily injury by disease - \$500,000 each employee	January 1, 2015 to January 1, 2016